

Gary L. Phillips
General Attorney &
Assistant General Counsel

SBC Telecommunications, Inc.
1401 Eye Street, NW
Suite 400
Washington, D.C. 20005

202-326-8910. Phone
202-408-8731. Facsimile



March 15, 2004

VIA ELECTRONIC SUBMISSION

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW – Lobby Level
Washington, D.C. 20036

Re: ***Notice of Ex Parte – CC Docket Nos. 93-193, 94-65, and 94-157***
Verizon Telephone Companies Petition for Reconsideration,
“In the Matter of Stale or Moot Docketed Proceedings”

Dear Ms. Dortch:

On March 15, 2004, Davida Grant, David Cartwright, Michael Alarcon and the undersigned, on behalf of SBC Telecommunications, met with Jay Atkinson, Deena Shetler, and Andrew Mulitz of the Wireline Competition Bureau and Debra Weiner and Andrea Kearney of the Office of General Counsel to discuss the above referenced proceeding. During the course of the meeting, we reiterated SBC’s legal positions as it reflected in its previous filings. SBC utilized the attached document as the basis for discussion.

Pursuant to 1.1206 of the Commission’s Rules, this letter is being filed electronically with the Commission.

Sincerely,

/s/ Gary L. Phillips

Attachment

cc (via electronic mail):

J. Atkinson
D. Shetler
A. Mulitz

I. Paragraph 136 of the 1990 *Price Caps Order* is not an Indication that Add-Back Was Contemplated

- Paragraph 136 states, in relevant part: “Furthermore, the sharing mechanism operates only as a one-time adjustment to a single year’s rates, so a LEC would not risk affecting future earnings, as it would in the case of the stabilizer we had previously considered.”
- For the following reasons, this language provides no basis for the Commission to conclude that it was unreasonable for LECs not to have applied add-back prior to the adoption of a rule requiring add-back.

(A) This paragraph has nothing to do with add-back.

(B) Add-back *does*, in fact, affect future earnings.

(A) Paragraph 136 Has Nothing to do with Add-back.

- In paragraph 136, the Commission explains the difference between how the PCI is calculated under the sharing mechanism it adopted versus how the PCI would have been calculated under the automatic stabilizer approach it had proposed.
- As the language at issue in paragraph 136 notes, the sharing mechanism the Commission adopted in the price caps order was different from the “stabilizer” approach it had proposed in the NPRM. Under the stabilizer mechanism, if a carrier’s earnings exceeded a specified earnings level, it would be required to lower its PCI during the following year to a level that would have achieved earnings no higher than that specified level. ***That lowered PCI would then be the starting point for any further modifications to the PCI in subsequent years.***¹
- By contrast, under the sharing mechanism adopted by the Commission in lieu of the stabilizer approach, PCI reductions attributable to sharing are ignored when making further adjustments to the PCI in subsequent years.
- The following example illustrates the point being made in paragraph 136:

¹ *Policy and Rules Concerning Rates for Dominant Carriers, Supplemental Notice of Proposed Rulemaking*, 5 FCC Rcd 2176, para. 162 (1990) (*Supplemental Notice*). The Commission’s proposal actually combined the automatic stabilizer and sharing mechanisms. Thus, a carrier could actually have to lower its PCI twice in a given year.

Assumptions for Example:

- In year 1, the PCI = 100
- For purposes of this example, the productivity index (x factor) and CPI are the same, so that, absent sharing or application of the stabilizer mechanism, the PCI would remain at 100 in all subsequent years.
- The automatic stabilizer mechanism is triggered when earnings exceed 13%
- Sharing is triggered when earnings exceed 13%
- During year 1, earnings = 15%
- During year 2, earnings (without add-back) = 13%

Operation of Stabilizer Mechanism: Under the automatic stabilizer mechanism, the PCI would be revised in year 2 to the level that would have produced a 13% return in year 1. Assume, for purposes of this example, that this adjustment would reduce the PCI in year 2 to 87. Under the stabilizer mechanism, that adjustment would be carried forward to year 3, so that the PCI in year 3 would remain at 87.

Operation of Sharing Mechanism Actually Adopted: Under the sharing mechanism, in Year 2, the carrier would have to lower its PCI by half of its earnings between 13% and 15%. Let's assume that this sharing reduced the year 2 PCI from 100 to 93.5. Under the sharing mechanism, the PCI in year 3 returns to 100 because the sharing adjustment in year 2 is not carried over to year 3 and no further sharing is required based on year 2 actual earnings.

(B) Add Back Does, in fact, Affect Future Earnings.

- Add-back represents an *adjustment* to year 2 earnings that can affect the sharing obligation associated with those earnings. In this respect, add-back affects, not only year 2 earnings, but year 3 earnings, as well.

Example without add-back. Assume the following facts: (1) In every Year except Year 2, the carrier can generate \$2400 in revenues; (2) In Year 2, the carrier can only generate revenues of \$2300; (3) the carrier's expenses and rate base are constant; and (4) sharing is required for earnings above 12%.

	Year 1	Year 2	Year 3
Amount required to be shared from previous year.		(100)	
Revenues	2,400	2,200	2,300
Expenses	(1,000)	(1,000)	(1000)
Earnings	1,400	1,200	1,300
Rate Base	10,000	10,000	
ROR	14.00%	12.00%	
Share over	12.00%	12.00%	
Over earned	200	0	

In Year 1, the carrier over earned by \$200.00 and therefore has to share one-half of this amount (\$100.00) the following year. This sharing is reflected in Year 2, as a reduction in revenues. In year 2, the carrier as a result of the lower PCI and other factors, revenues dipped to 2200 and earnings dipped to 1200 or 12% ROR. Thus, no sharing obligation is triggered for year 3. Stated differently, the initial sharing from year 1 has no impact on any year's earnings other than year 2 earnings.

In contrast, using the same example with add-back, the \$100.00 sharing obligation triggered in Year 1 would trigger a sharing obligation in Year 2 and subsequent years.

	Year 1	Year 2	Year 3
Amount required to be shared from previous year.		(100)	(50)
Revenues	2,400	2,200	2250
Expenses	(1,000)	(1,000)	(1,000)
Rate Base	10,000	10,000	10,000
Earnings	1,400	1,200	1250
ROR	14.00%	12.00%	
Add-back Adjustment		100	
Adjusted Earnings (for sharing purposes)		1300	
Share over	12.00%	12.00%	
Amount shared	100	50	

Year 2, the carrier now has earnings of \$1300.00 or a 13% ROR, thus triggering a sharing obligation of \$50.00 in Year 3. Year 3 earnings are thus inflated by \$50.00. Said another way, with add-back, the \$100 sharing obligation from Year 1, not only impacts the earnings for Year 2 (i.e. increases actual earnings by \$100.00), but the earnings for Year 3 (inflates by \$50) and Year 4 (inflates by \$100.00).